NORTHERN ILLINOIS UNIVERSITY

"Postretirement Benefits Other Than Pensions: The Effects on a Company's Financial Statements and Postretirement Benefit Policies"

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ABSTRACT:

Prior to 1990, health care costs were escalating at an annual rate of up to 22%. Due to this increase, the FASB was not satisfied with how businesses were reporting their postretirement expenses and drafted SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." SFAS 106 required employers to record postretirement expenses under the accrual method, not the cash basis method that the majority of companies were recording. The impact on corporations was immense, with an increase in industry costs estimated from $400 billion to $1 trillion.

This paper defines what postretirement expenses are, examines current reporting requirements, analyzes selected company's annual reports for the impact of SFAS 106, and analyzes how companies have reacted to SFAS 106. To accomplish my goals, I researched SFAS 106, analyzed numerous financial reports, and read articles written about the impact about SFAS 106. What I discovered is that health care costs have decreased significantly since the implementation of SFAS 106, as a result of companies understanding the magnitude of their postretirement expenses and attempting to decrease these costs. Most employers have reacted to the increased cost of postretirement benefits in some manner; some corporations have either reduced or eliminated postretirement benefits, some corporations have made employees pay a greater share of their postretirement benefits, and some corporations have funded their postretirement expenses.

TABLE OF CONTENTS

INTRODUCTION

In 1990, health care costs were perhaps the most highly controversial subject for businesses. Health care costs had escalated to the point where businesses could no longer ignore them. From 1983 to 1989 "health care costs had ranged from 9% in 1985 and 1986 up to 22% in 1988, and were up to over 20% in 1989" (Ihlanfeldt 1). In 1990 over 12% of the Gross National Products was comprised of health care costs, totaling over $650 billion.

Health care cost increases have not only impacted America, but the U.S. per-capital health care costs are significantly greater than other countries:
171% more than Great Britain; 124% more than Japan; 88% more than West Germany; and 38% more than Canada. (Chassen 28)

A contributing factor to the greater costs is that medical inflation had outpaced the general inflation in all but three years since 1960. (Ihlanfeldt 1) In an attempt to expand the average American's life, expensive new technology and expensive medication were made available. Also, an increase in the cases of AIDS, substance abuse, and mental health cases had contributed to the escalating costs.

An indirect cause of health care inflation is that there were over 37 million uninsured Americans in 1990. Hospitals, being legally obligated to serve the uninsured, lost a tremendous amount of revenue serving these individuals. As a result of these unpaid health care costs, hospitals and other health care providers have distributed these costs to those individuals with insurers, which have been pushed down to the corporations.

POSTRETIREMENT EXPENSE

The escalating health care costs impact employer's expenses for all employees; both active and retired. However, employer postretirement expenses have increased more than the active employees expenses due to issues which do not pertain to active employees. One cause for the increase in postretirement expenses is the decline in Medicare payments. In the last several years Medicare payments have decreased due to projections of future Medicare deficiencies. Since most postretirement insurance plans are supplemental to Medicare and are defined benefit (provide for a certain percentage of health care costs), the more medical costs Medicare pays, the less companies will spend.

> Studies indicate that a small reduction in Medicare reimbursements translates into a disproportionately large increase in corporate medical costs. As an example, if Medicare cuts its reimbursements by 5% corporate health care costs for retirees 65 years and older could rise 15%. (Arthur Andersen 2)

Along with a decrease in Medicare payments, a shift in the number of retired workers has resulted in increased postretirement expenses. As employee life expectancy has increased, many mature companies have had an increasingly larger percentage and number of retirees to active employees. "In 1974, the average Fortune 500 Company had 12 active employees to every retiree. Not it has three" (Arthur Andersen 2).

Postretirement expenses have also increased because of downsizing and early retirement. Many companies have looked for ways to lower corporate costs and maintain a good relationship with their employees. One of the best ways to accomplish this goal is to allow early retirement. These corporations are beginning to realize that early retirement has drastically increased postretirement expenses for two reasons. First, the company has to provide health care services to more retirees. Second, unlike other retirees who are over 65, the companies must provide primary insurance to retirees since they cannot receive Medicare.

POSTRETIREMENT BENEFITS DEFINED

The Financial Accounting Standards Board (FASB) defines postretirement benefits other than pensions as:

> All forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits. (FASB, Statement of Financial Standards 106, 203)

SFAS 106 applies to all forms of postretirement benefits, but both the Statement and this paper focus primarily on postretirement health care benefits. This paper will refer to postretirement benefits other than pensions as postretirement benefits or postretirement expenses.

ACCOUNTING BEFORE SFAS 106

The FASB first considered postretirement expense an important issue which must be addressed in 1979 as part of its pension project. In 1984, postretirement expense was identified as a separate project, and SFAS 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits*, was issued.

Under SFAS 81, postretirement expense was allowed to reported as an obligation on the pay-as-you-go (cash basis) or accrual basis, whichever the employer chose. Very few companies chose to account for postretirement expense on the accrual basis because of the additional costs and requirements of obtaining all the necessary information. As a result of the increased costs of postretirement benefits discussed under the "Postretirement Expense" section (primarily increased number and proportion of retirees, decrease in Medicare payments, and early retirement), the FASB believed that companies were not reporting their true obligation of postretirement obligations. In order to account for this "unrecorded obligation" the FASB issued SFAS 106 in December, 1990.

SFAS 106

Under SFAS 106, the FASB views the postretirement benefits as part of an employee's compensation for service rendered because there is a promise between the employer/employee to provide postretirement services in exchange for present employment. As a result, the pay-as-you-go approach to recognizing the liability is no longer permitted, instead the accrual method of accounting is required.

Under SFAS 106, the present value of postretirement expense must be recognized and fully accrued by the date the employee is fully eligible to receive benefits. (Wilbert and Dakdduk 38) This date may or may not coincide with the age of retirement, but instead is based on a combination of age and years of service. For example, an employee may need to be 55 years old and have worked with the company for more than 10 years.

SFAS 106 applies to three groups:

1. Retirees and dependents currently receiving benefits
2. Active employees eligible for retirement benefits
3. Active employees not yet eligible for retirement benefits

Substantive Plan

SFAS 106 requires employers to account for postretirement benefits by using the substantive plan. The substantive plan is the plan which the employer and employee understand the postretirement benefits will be at retirement. Normally, the employer's written plan is the best representation of the substantive plan, however, employers should estimate the impact of future changes to the cost sharing provisions. Two key elements must be considered in addition to the written plan:

1. The employer's past practice of maintaining a consistent level or consistently reducing/increasing the level of cost sharing between the employer and retirees, including deductible, co-insurance, and retiree contributions.

2. If the employer intends to change its cost sharing provisions and has communicated this change to the plan participants.

Assumptions

The FASB realizes that all the estimates required by the Statement cannot be accurately forecasted. However, the board believes these estimates are far superior to not recognizing, or accruing, postretirement costs or obligation. "Explicit Assumptions" are required which are the employer's best estimate of future events which include:

* The discount rate - reflects the time value of money and impacts both the APBO and EPBO (discussed later)
* Retirement age
* Factors which affect future benefits payments - per capita claims cost by age, health care cost trend rates, and Medicare reimbursement rates. Medicare reimbursement rates are assumed to be continued as they are currently being paid. Health care cost trend rates reflect the annual changes in health care benefits which are affected by health care inflation, changes in health care utilization, technological advancements, and changes in the health status of plan participants.
* The expected long term rate of return on plan assets

EPBO and APBO

Two elements must be considered when calculating postretirement expense; Expected Postretirement Benefit Obligation (EPBO) and Accumulated Postretirement Benefit Obligation (APBO). EPBO is the actuarial present value of benefits expected to be paid while APBO is the actuarial present value of services rendered to date. It is crucial to understand these two concepts because they serve as the basis for calculating several components of postretirement expense.

The APBO is a portion of the EPBO before the date of full eligibility because it represents only the current services rendered. The remainder of EPBO is comprised of future service costs of active employees who have not reached full eligibility. Since all EPBO must be recognized by the date of full eligibility, APBO equals EPBO at the point of full eligibility.

Components of Postretirement Benefits

The net period postretirement benefit consists of 6 elements:

1. Service cost
2. Interest cost
3. Expected return on plan assets
4. Amortization of unrecognized prior service costs
5. Gain or loss to the extent recognized
6. Amortization of the unrecognized obligation/asset at the date of initiation

Service Cost

The service cost represents the current year's portion of EPBO. Service cost is calculated as follows: Service cost = $\frac{1}{\text{Full eligibility service years}}$ X EPBO

Interest Cost

Since APBO is a present value calculation, the interest cost represents the accrual of the APBO. SFAS 106 requires that "the assumed discount rates (interest cost)... should reflect the rates at which an amount invested at the measurement date in a portfolio of high-quality debt instruments would provide the necessary future cash flows to pay benefits when due" (FASB, A Guide to Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other Than Pensions, 4).

Actual Return on Plan Assets

Actual return of plan assets represents the after-tax return on assets set aside to fund the promised postretirement benefits. Unlike SFAS 87, dealing with pensions, employers are not required to fund their postretirement expenses. Therefore, many companies will find the component negligible or non-existent.

Prior Service Cost

Prior service costs result from plan initiation or amendments which increase or decrease prior service costs. In the instance of increased benefits, it is assumed that the amendment will have a positive impact on employees future services. As a result of this future benefit, the service cost must be amortized over the remaining years of service until full eligibility. If most or all the plan's participants are already fully eligible, the prior service cost is amortized over the participants remaining life expectancy.

In the instance of a decrease in benefits, it is assumed that there will be no future benefits received by the company. This obligation reduction first reduces any existing unrecorded prior service costs, then reduces any remaining unrecorded

If a company recognizes gains or losses immediately, "any gain that does not offset a loss previously recognized in income... shall first offset any unrecognized transition obligation; any loss that does not offset a gain previously recognized... shall first offset any unrecognized transition asset" (FASB, Statement of Financial Accounting Standards No. 106, 20). If amortization is chosen, the excess amount must be amortized over the remaining service period of active plan participants, unless most participants are inactive, where the remaining life expectancy shall be used.

"If an employer deviates from the substantive plan on a one-time basis to either increase or decrease benefit payments relating to current or past periods, the effect of the temporary deviation is recognized immediately as a gain or loss. Under the Statement deferral is never allowed" (Wilson and Fields 42).

Transition Obligation (Asset)

The transition amount reflects the unfunded (overfunded) APBO at the date of SFAS 106 initiation. The transition amount is calculated as follows:

Transition amount = APBO - (Fair Value of Plan Assets + Accrued Costs - Prepaid Costs)

The FASB allows the transition amount to be recognized immediately or delayed. If immediate recognition is chosen, the full transition amount is recorded as an expense (income) in the Income Statement.

If delayed recognition is chosen, the employer must amortize the transition amount on a straight-line basis over the greater of: a) the average remaining service period of active plan participants; or b) 20 years. If, however, the majority of the plan participants are inactive, the transition amount must be amortized over the average remaining life expectancy of the participants. The Statement also requires that the minimum transition amount recognized must equal the annual amount of cash expended for postretirement benefits (pay-as-you-go basis).

Disclosure

Under SFAS 106, the employer must disclose:

1. A description of the substantive plan(s) - includes the nature of the plan, any current modification to the plan, employee groups covered, benefits provided, funding policy, and types of assets held;
2. The amount of postretirement expenses broken down into each cost component;
3. A schedule reconciling the plan's funded component with amounts reported on the employer's Statement of Financial Position;
4. The assumed health care cost trend rate for the next year as a well as a general description of the direction and pattern of change in the assumed discount rates and when the trend rate is expected to be achieved;
5. The assumed discount rate used to calculate the APBO; and
6. A sensitivity analysis of a one percent change in health care cost rate trends for interest cost and the APBO.

CASE STUDY ANALYSIS

General Motors Corp (See **Appendix A**)

General Motors (GM) implemented SFAS 106 in 1992 and decided to recognize the obligation immediately. Immediate recognition resulted in a -$20,877.7 million cumulative effect of accounting change and a $23,498.3 million loss. GM's 1992 loss was the largest ever for any United States company, eclipsing

Ford Corporation's earlier 1992 loss. Ford recognized a $7.5 billion dollar cumulative effect of accounting change due to SFAS 106 in the same year.

SFAS 106 affects the corporation's financial statements beginning in 1992. The company recognized a -$20,877.7 million cumulative effect of accounting change in its 1992 Income Statement, or 88.9% of its net loss for the year. The net loss was also increased by $2,198.8 million ($1,384.2 million after taxes) because of 1992's postretirement expense, the incremental ongoing effect of recognizing a greater total non-pension postretirement benefits cost than the former "pay-as-you-go" approach which only recognized retiree benefits payments. Therefore, the net effect of SFAS 106 on the 1992 Income Statement was -$22,261.9 million (net of taxes), or 94.7% of the total loss for 1992.

The company also recorded a $35,550.7 million postretirement benefits other than pensions liability in its Balance Sheet, composing 19.4% of its total liabilities. In 1992 this was the company's third largest liability behind notes and loans payable and other liabilities and deferred credits. SFAS 106 also decreased GM's retained earnings (stockholder's equity) because of the resulting loss in the Income Statement.

GM's postretirement expense only consists of two of the six postretirement elements discussed previously; service cost and interest cost. Interest cost, the accrual of APBO, accounted for 80.6% of total postretirement expense, while service cost accounted for the remaining 19.4% in 1992. GM does not own any plan assets for postretirement benefits other than pensions; therefore, postretirement benefits does not include actual return on plan assets. Since the company elected immediate recognition, it cannot include amortization of unrecognized obligation. Amortization of unrecognized prior service cost and gain or loss to the extent realized are not applicable.

AT&T (See **Appendix A**)

AT&T implemented SFAS 106 in 1993 and recognized the obligation immediately. Immediate recognition resulted in a $7,023 million ($4.54 per common share) cumulative effect of accounting change in its 1992 Income Statement, or 189.7% of the income before cumulative effect of accounting changes. The company also recorded a $7,816 million postretirement benefit other than pension liability ($8,754 million including postemployment benefit liability) in its Balance Sheet, consisting of 12.97% of its total liabilities. This was the company's third largest liability in 1993, behind debt maturing within one year and long-term debt including capital leases. SFAS 106 also decreased AT&T's retained earnings (stockholder's equity) because of the resulting loss in the Income Statement.

AT&T contains five of the six postretirement elements discussed previously with the exception of amortization of the unrecognized obligation. Amortization of unrecognized obligation is not included because AT&T chose immediate recognition of SFAS 106. The company does have plan assets consisting of listed stocks, corporate and governmental debt, cash and cash equivalents, and life insurance contracts. In 1994 and 1995. plan assets consisted of 32.75% and 37.42% of APBO, respectively. The expected return on plan assets was used to calculate postretirement expense, not actual return, even though there was a discrepancy of $273 million and $-664 in 1994 and 1995, respectively. These discrepancies were included in the amortization of net loss (gain) for their respective years.

National Steel (See **Appendix A**)

National Steel implemented SFAS 106 in 1993 and elected to amortize the obligation over 20 years. Since amortization was chosen, there was no cumulative effect of accounting change, rather the obligation must be amortized and included in the postretirement expense. The amortization of transition obligation accounted for

$28,071,000 in 1993 or 22.7% of the postretirement expense. The company began prefunding the postretirement obligation in 1994 with a Voluntary Employee Benefit Association Trust (VEBA). In 1995 the company had assets of $33,200,000, 4.62% of APBO, consisting of 60% equity investments and 40% fixed income investments.

National Steel recorded a 1995 postretirement benefits other than pensions liability of $221,627,000 in its Balance Sheet, comprising 10.5% of total liabilities. If the company elected to immediately recognize the obligation, the balance sheet liability would have been increased by the unrecognized transition obligation of $446,654,000. The total postretirement benefit liability would then equal $668,281,000; 26.1% of total liabilities and 302% larger than the second largest liability.

Prior to 1993, National Steel provided contributory health care and life insurance benefits for retirees (and their dependents) who retired with a company pension plan and had at least 15 years of continuous service. In 1993, the year SFAS 106 was implemented, salaried employees hired after January 1, 1993 were no longer eligible to participate in postretirement benefit plans.

Observations

All three companies believe that the health care cost trend rates will decrease in the future. General Motors disclosed its ultimate trend rate at 5.5% by 2,006, AT&T disclosed its ultimate trend rate at 4.9% by 2,005, and National Steel disclosed its ultimate trend rate at 5% by 2,002. Each company will linearly (gradually) decrease its current health care cost trend rate until the ultimate trend rate will be realized.

In addition to decreasing health care cost trend rates, the three companies have also recognized decreases in the weighted-average discount rate. The discount rate reflects the time value of money, therefore it directly effects the APBO and the long term postretirement benefit liability. GM disclosed that a one percent decrease in the assumed discount rate in 1993 would result in a $5.5 billion dollar increase in APBO. The decrease in the discount rate has resulted in the majority of the APBO increases, causing the companies to recognize a larger percentage of their APBO for postretirement costs.

General Motors and AT&T chose to immediately recognize their transition obligations, while National Steel amortized their transition obligation over a twenty year period. Choosing immediate recognition or amortizing the recognition affects the corporations in two ways; the total postretirement benefit cost and the long term postretirement benefit liability. GM and AT&T recognized the cumulative effect of this accounting change immediately, therefore they took a one-time only impact on their Income Statements (in the year of implementation). National Steel amortized the cumulative effect over a twenty-year period, therefore they must recognize a portion of this cost each year until the twentieth year. Since GM and AT&T chose to recognize the entire amount immediately, they were allowed to list SFAS 106 as a "Cumulative effect of an accounting change". Therefore, their income before cumulative effect of accounting changes (ordinary income) was not impacted and the financial statements reader could determine SFAS 106's impact on the Income Statement without having to read the Financial Footnotes.

National Steel's amortization of SFAS 106 also impacts the amount of long term postretirement benefit liability they must recognize. In 1994, the company decreased their long term postretirement benefit liability by $477,489,000 with their unrecognized transition obligation. This unrecognized transition obligation accounted for 93.96% of their APBO and exceeded their long term postretirement benefit by 266%. GM and AT&T are not allowed an unrecognized transition obligation because they chose immediate recognition and not amortization of SFAS 106.

The effect of SFAS 106 was immense for all the companies in the case study. Postretirement benefits other than pensions was the third largest liability for General Motors and AT&T, accounting for 19.4 and 12.97 percent of total liabilities, respectively. The postretirement liability was not as large for National Steel, accounting for 10.5% of total liabilities; however, had immediate recognition been elected, the liability would have been the company's largest, consisting of over one-quarter of their total liabilities.

SFAS 106 had a devastating effect on the Income Statement for both General Motors and AT&T, accounting for multi-billion dollar losses. In addition to the one-time "hit", the accounting standard also can impact the companies annually. The postretirement expense is normally larger than the "pay-as-you-go" method, therefore all applicable companies must recognize a larger cost. In 1993, General Motors recognized an excess amount of $1,486.8 million (net of taxes), while National Steel recognized an excess amount of $97.6 million. General Motors' postretirement cost in 1993 was 176.3% larger than the accompanying payments.

Perhaps the greatest effect of SFAS 106 is how companies subsequently reacted to its implementation. In 1993, National Steel terminated its postretirement benefits for any employees hired in the future. Although the company did not disclose that postretirement benefits were terminated due to the accounting change, it can be implied. Future postretirement costs and postretirement liability will be decreased in the future as a result of the termination because fewer employees will be eligible.

DECREASING POSTRETIREMENT EXPENSE

SFAS 106 has awakened many employers to realize the magnitude of health care costs for both active and retired employees. As a result of this knowledge, employers have four alternatives to handle health care costs:

1. Continue the current health care benefits and future plan changes
2. Maintain the current health care benefits, but do not increase them in the future
3. Eliminate health care benefits
4. Redesign health care benefits to reduce health care costs

Redesigning Health care Benefits

If companies choose to redesign health care benefits, there are many ways to reduce costs. Employers have the options of: enforcing tighter eligibility requirements; increasing cost sharing with retirees; using non-traditional health care providers; reducing benefits; establishing plan assets for health care costs; and shifting from a defined benefit plan to a defined contribution plan.

Tighter Eligibility Requirements

When SFAS 106 was first issued in 1990, most companies did not have all the information needed for calculating postretirement costs. Until this information was obtained, most companies did not know the magnitude of postretirement expenses and many companies did not even know who was eligible to receive health care benefits. Eligibility is a crucial aspect of postretirement benefits and can reduce costs two ways: (Mack and Oss 22)

1. Extend required years of service. This may eliminate some retirees from receiving benefits if they did not work long enough for the company, thus decreasing the number of plan participants. Also, extending years of service

postpones the date the EPBO must be amortized over and would decrease the yearly expenditure.

2. Reduce or eliminate the retirees' "dependents" who receive health care benefits. Many benefits plans do not indicate who is eligible as dependents or provide any restrictions. Marital status, age, and residence should all be considered in the substantive plan because a change in policy could delay or eliminate postretirement costs for retirees' dependents.

Increase Cost-Sharing

Employers can decrease their postretirement costs by shifting some of these expenses to the employee. Cost shifting can be comprised of increasing deductibles and co-payments or increasing beneficiary contributions to premium costs. (Mack and Oss 23)

Deductibles are the amount the retiree must pay annually before their insurance begins covering health care costs. Co-payments are the portion of the health care costs the retiree must cover annually. Increasing deductibles and co-payments are effective in decreasing postretirement expense because the employee is paying more of the costs and because retirees tend to use less health care services when they have to fund a portion of the costs.

In addition to increasing deductibles and co-payments, many employers are requiring retirees to pay a portion of their premium costs. Premiums are the amount that the retirees' insurance company charges monthly for providing health care benefits. By shifting these expenses to the employees, an employer can decrease its health care expense.

Non-Traditional Health care Providers

The use of non-traditional health care providers can drastically decrease employers' health care costs. Traditional health care insurance plans allow patients to go to virtually any hospital or doctor they choose. Patients pay their deductible and their share of the charges, and the rest of the expenses are covered by the plan. Non-traditional plans differ by placing greater restrictions on the health care benefits offered. Non-traditional providers include Preferred Provider Organization (PPO) and Health Maintenance Organization (HMO).

PPO plans help reduce costs by decreasing medical costs. Hospitals and doctors join a PPO network, offering to provide their services for a reduced charge. The patients pay their deductibles and portion of their charges, which are normally a lower percentage than traditional plans. PPOs are more restrictive than traditional plans because they restrict which hospitals and doctors patients can use at these reduced fees; if they choose to use non-network providers they must pay a greater percentage of total costs.

HMO plans are very similar to PPO plans. HMO plans reduce medical costs by restricting which hospitals and doctors the patients can use. HMOs normally cost the employees less money than PPOs, however, there is even greater restrictions on which hospitals and doctors the patients can use, often times not paying any coverage for providers not in their network.

In addition to agreements with hospitals and doctors, non-traditional providers often employ preventive services and cost containment programs (preadmission certification and second surgical opinions) to maintain lower costs. Despite these efforts to keep costs down, there is no guarantee employers will pay lower premiums than if they used traditional providers, although they have in the past few years. In 1996, HMO premiums averaged between $146.20 and $164.20 depending on geographic region, while traditional premiums averaged between

$154.41 and $196.58. (KPMG, "Your Health Care Premium Increases Should Be Less Than 1%", 2)

Reducing Benefits

Benefits can be reduced for current employees, future employees, or all employees. Although reduction of benefits would be the most effective means of reducing employer health care costs, it also represents the most problematic way. Employees view reduction of benefits very negatively, both for lowering their morale and decreasing the competitiveness of their employment.

In addition to employee relations, legal issues must also be considered. Companies which change their current employees' benefits are likely to be sued and lose in court, while changes in future employees' benefits are not.

> A closer look at the evolution of retiree medical benefits cases yields the conclusion that they are firmly grounded in the law of contract interpretation. The contract for retiree medical benefits is established by:
> - the employer's promise of medical coverage during the employees' retirement, and
> - the employees working in expectation of coverage.
>
> Under this analysis, the employee's ability to earn medical benefits and the employer's ability to change or end the retiree medical program are not inherently part of such a contract. Rather these issue arise in the formalization of the contract -- the plan documents and insurance contracts. (Mercer 1-2)

Some courts will only look at the employee contract to determine if employers can reduce employee benefits, while others look at supporting documents as well. The documents the courts look at must "clearly reserve for the employer the right to modify or terminate the retiree medical program" for the employer to successfully decrease benefits (Mercer 2). As a result of the difficulty in changing health care benefits, most employers change benefits for future employees.

Plan Assets

Establishing plan assets help fund a corporation's postretirement benefits. The objective of plan assets is that they appreciate and can be used in future years to fund the postretirement benefits. If plan assets appreciate at a greater rate than the health care trend rate, than less payments will be required in the future since the excess interest can partially fund the postretirement expense. Therefore, plan assets do not actually decrease the cost of insurance premiums, rather they reduce the amount of future payments.

Defined Contribution Plan

Most companies choose to provide defined benefit plans over defined contribution plans. Defined benefit plans provide a certain amount of benefits to be received in the future. For example, a defined benefit plan might pay 80% of all medical expenses or provide for 60 days of hospital coverage per year. Defined contribution plans provide that the employer will pay up to a certain amount of money per year for an employee's health care (for example, $1,000 in premiums per year).

Defined contribution plans offer two advantages over defined benefit plans. Employers are only required to pay up to a certain amount of money per year, therefore there is a cap on how much the employer will pay. Under a defined benefit plan, the employer may be required to pay more money if the employee requires extensive medical coverage.

Defined contribution plans are also advantageous in that they make estimating retiree liability more accurate and less complicated. Since payments are based on a contribution amount and not on providing a certain level of benefits, the Health Care Cost Trend Rate is eliminated. As a result of not requiring the use of an estimated amount of health care inflation, the liability amount will be more accurate and the employer will be able to prefund this liability more easily.

FUNDING ISSUES

Employers can pay for postretirement expenses two ways: pay-as-you-go or funding. Employers implementing the pay-as-you-go method pay for the yearly cash outlays of postretirement expense out of corporate earnings or equity. Employers who fund their postretirement benefits establish and fund trusts which accumulate assets, and these assets are used to fund current and future postretirement expenses.

Most employers still finance their postretirement benefits with the pay-as-you-go method instead of funding for tax reasons. Unlike pensions which are legally required to be funded, the government places no requirements for corporations to fund their postretirement benefits. In order to encourage funding pensions, the government provided tax-free methods for the corporation to decrease their funding requirements (Section 401 of the tax code). Since there is no requirement to fund postretirement benefits, the government has not provided many effective tax-free ways to fund postretirement benefits. However, there are two effective means for funding postretirement benefits: a 401(h) trust and a 501(c)(9) (VEBA) trust.

Section 401(h) of the tax code provides that the corporation can designate up to 25% of its pension contribution towards health care costs, which can be directed towards postretirement expenses. Despite the potential tax advantages of this code, many companies are not able to take full advantage since their pension plans are overfunded and the corporation is not required to contribute anything to the plan. (Bazzle 27)

A VEBA (Voluntary Employee Benefit Association) can reduce dramatically the total cash outlay for medical benefits. For a typical firm with 4,500 retirees and 14,000 activees, the VEBA's accumulated outlay is higher for the first 16 years, but it eventually saves the corporation over $1.3 billion. (See **appendix B**)

> In 1984, ... the Deficit Reduction Act tax-writing staff incorrectly perceived corporate abuses and essentially emasculated the VEBA trust by, among other things, limiting the amount of tax-deductible contribution and subjecting asset earnings designated for this purpose to income tax as unrelated business income (UBI). It takes about five minutes to determine that the present value cost of pre-funding with assets subject to tax is roughly equivalent to the traditional pay-as-you-go system and that such an approach is financially unattractive. (Bazzle 27)

There are only two assets which are tax-free under the UBI restriction of a VEBA: tax-free bonds and life insurance policies. Due to restrictions of tax-free bonds, life insurance policies are the most widely used vehicle for VEBAs. Despite being the most commonly used form of prefunding VEBAs, there are issues regarding whether or not employers' life insurance polices on their employees are legal. Despite these potential legal complications, life insurance funded VEBAs remain the best funding vehicle.

Employers fund the trust with cash contributions and designate a trustee to invest the contributions in the life insurance policies of selected employees. The trustee uses future contributions to increase insurance coverage and pays the current postretirement expenses (cash outlays) by withdrawing from the insurance policies, not from death benefits. Although death benefits can be used to fund current postretirement expenses, it is advantageous to reinvest these proceeds into existing policies to prevent potential taxation under the UBI restrictions.

The greatest potential difficulty in using life insurance funded VEBAs is the potential legal issue of "whether or not the corporation or trust has a legitimate insurable interest in the lives of employees" (Bazzle 29). If it is determined that the employer or trust does not have such right, then the insurance company may refuse to pay death benefits and policy proceeds and the IRS may deem the VEBA policy proceeds as being taxable to the corporation.

Insurable interests are defined by limited state statutory definitions, however, is normally determined in the common law venue. "It is generally accepted that, in the case of the employer/employee insurance, the employer should reasonably expect to reap pecuniary benefit through continued life of the employee and to sustain consequent loss upon the employee's death" (Bazzle 29).

Most courts currently recognize "the basic economic value of an employee to an employer because of the accumulated knowledge, training, skill, and experience of the employee. Evidence of this value is the salary paid to the employee" (Bazzle 29). Therefore employers are normally allowed to legally finance VEBAs though tax-free life insurance proceeds, which remain the best funding medium.

CURRENT HEALTH CARE TRENDS

Since SFAS 106 was drafted in 1990, health care costs, as measured by health insurance premiums, have drastically decreased. (See **Appendix C**) Health care premiums have decreased in each of the last seven years, beginning in 1990 when SFAS 106 was drafted by the FASB. In 1995 and 1996, health insurance has increased less than the overall inflation according to the consumer price index and the medical consumer price index, something which has rarely occurred since 1960. The increase in health care rates of only .5% in 1996 represents the lowest increase on record.

HMOs have incurred the lowest premium increases in the past two years, with premiums actually decreasing by .4% in 1996. The largest increase in 1996 was 1.2% by both conventional providers and point-of-service (POS) providers, while PPOs increased by .64%. One potential explanation of how HMOs were able to decrease their premiums is the increase in HMO enrollments. HMOs are currently the largest insurance provider, accounting for 33% of all enrollments. Larger enrollments make it possible for HMOs to make better deals with hospitals and health care providers who want HMO's increased business. In addition to HMOs, "managed care enrollments reached 74% of all enrollments nationwide up from just 29% in 1988. (KPMG, 2)"

Although the general health care costs have decreased so rapidly, postretirement benefits have not decreased quite so rapidly. Despite slower decreases than the general health care costs, postretirement health care costs have drastically decreased. While active employees only recognized an 8% increase in premiums for 1993, retirees recognized an increase in premiums of 11%. If SFAS 106 had impacted how employers viewed postretirement expenses, it would probably be more logical that retiree premiums would decrease more than active premiums. There are several reasons why retiree premiums have decreased less, however, as discussed below.

While HMOs have become the predominant insurance provider for active employees, it has not been nearly as successful for retirees. In 1993, only 7% of all retirees received insurance coverage under HMOs.

> Two possible explanations for retirees' dramatically lower participation in managed care can be offered. First, employers have fewer opportunities to explain the advantages of managed-care plans to retirees than to active employees at the work site every day. Second, retirees may be reluctant to give up the health plan coverage they have become accustomed to over a period of many years. (KMPG, "Retiree Health Benefits: The Uncertainty Continues", 3)

Since HMOs represent only a small fraction of retirees, they do not have the bargaining power with hospitals and health care providers for the retirees that they do for active employees.

Another potential explanation for why retiree insurance premiums increases is based on Medicare. During the last several years, Medicare has been attempting to decrease their costs by paying health care providers less, often times resulting in the retirees or their insurance providers having to pay the remaining bill. Since the insurance provider may have to pay for a greater percentage of health care coverage, their insurance premiums will increase.

Although retiree health insurance premiums have not decreased as much as active employees' premiums, they have lowered postretirement expenses along with decreased costs through the methods discussed in "Decreasing Benefits". Between 1991 and 1994, more than one-third of the large employers had made changes to their postretirement benefits. The greatest changes were to increase premium contributions and cost-sharing, while the lowest changes were related to terminating postretirement plans. (See **Appendix D**) Despite the termination of some of the postretirement plans, 67% of large employers (5,000+) still provide retiree health coverage, 48% of mid-size employers (1,000-4,999) provide coverage, and 31% of small employers (200-999) provide coverage.

CONCLUSION

One of the four objectives of the Financial Accounting Standards Board implementing SFAS 106 was "to enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide postretirement benefits to its employees...". Not only did this accounting standard affect how financial statement users viewed postretirement and health care costs, it also affected how employers viewed these costs. Many companies did not realize the magnitude of the benefits they had promised to their employees until they were forced to make actuarial calculations; rather they were only aware of their cash outlays to pay for the postretirement costs.

In order to decrease future costs many companies followed the cost-saving strategies as outlined in "Decreasing Postretirement Benefits". As a result of employer's efforts, health care premiums increased only .5% in 1996, the "lowest health cost increase on record and comes at the end of seven consecutive years of decreases in the cost of employer-sponsored health coverage." Whether or not employers will be able to maintain such low increases in health care costs depends on future employees' perception of required health care, Federal legislation, and health care providers.

APPENDIX A
FINANCIAL STATEMENTS

GENERAL MOTORS CORP

CONSOLIDATED BALANCE SHEET
December 31

	1993	1992
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts Payable	10,276.5	9,678.4
Notes and loans payable	70,441.2	82,592.3
United States, foreign, and other income taxes deferred and payable	2,409.3	3,140.1
Postretirement benefits other than pensions	37,920	35,550.7
Pensions	22,631.6	13,756.2
Other liabilities and deferred credits	38,474.8	38,487.7
Total Liabilities	182,153.4	183,205.4
Total Stockholder Equity	5,597.5	6,225.6
Total Liabilities and Stockholder's Equity	188,200.9	190,196

STATEMENT OF CONSOLIDATED OPERATIONS
December 31

	1993	1992
Total Net Sales and Revenues	138,219.5	132,242.2
Cost of sales and other operating charges	106,421.9	105,248.4
Selling, general, and administrative expenses	11,531.9	11,232.2
Interest expense	5,673.7	7,096.8
Depreciation of real estate, plants, and equipment	6,576.3	6,144.8
Amortization of special tools	2,535.3	2,504
Amortization of intangible assets	330.4	310.2
Other deductions	1,624.7	1,801.9
Special provision for scheduled plant closings and other restructurings	950	1,237
Total Costs and Expenses	135,644.2	135,575.3
Income (Loss) before Income Taxes	2,575.3	(3333.1)
Income taxes	109.5	(712.5)
Income (Loss) before cumulative effect of accounting changes	2,465.8	(2620.6)
Cumulative effect of accounting change (Note 5)	NA	(20,877.7)
Net Income (Loss)	2,465.8	(23,498.3)
Cumulative effect of accounting change	NA	(33.43)

Note 5. Other Postretirement Benefits Effective January 1, 1992, the Corporation adopted SFAS No. 106, Employer's Accounting for Postretirement Benefits Other Than Pensions. This Statement requires that the cost of such benefits be recognized in the financial statements during the period employees provide service to the Corporation. The Corporations previous practice was to recognize the cost of such postretirement benefits when incurred (i.e., pay-as-you-go method). The cumulative effect of this accounting change as of January 1, 1992 was $33,116.1 million, or $20,837.7 million after-tax ($33.38 per share of $1-2/3 par value and $2.08 per share of Class H common stock). The incremental ongoing effect

in 1992 of this accounting change was to increase the loss before cumulative effect of accounting changes by $2,198.8 million, or $1,384.2 million after-tax ($2.05 per share of $1-2/3 par value and $0.11 per share of Class H common stock). The incremental ongoing effect in 1993 reduced net income by $1,486.8 million after-tax ($2.08 per share of $1-2/3 par value and $0.14 per share of Class H common stock).

The Corporation has disclosed in the financial statements certain amounts associated with estimated future postretirement benefits other than pensions and characterized such amounts as "accumulated postretirement benefit obligations," "liabilities", or "obligations". Notwithstanding the recording of such amounts and the use of these terms, the Corporation does not admit or otherwise acknowledge that such amounts or existing postretirement benefits plans of the Corporation (other than pensions) represent legally enforceable liabilities of the Corporation.

The total non-pension postretirement benefit cost of the Corporation and its subsidiaries, other than the cumulative effect of adopting SFAS No. 106, amounted to $4,163.4 million in 1992 and $3,700.7 million in 1992, and included the components set forth s follows:

	1993	1992
	(Dollars in Millions)	
Benefits earned during the year	811.5	717.9
Interest accrued on benefits earned in prior years	3,177.5	2,982.8
Cost of termination benefits	174.4	–
Total non-pension postretirement benefit cost	4,163.4	3,700.7

Retiree benefit payments were $1,428.3 million in 1991.

The table below displays the components of the Corporation's postretirement benefit plans with the obligation recognition in the Consolidated Balance Sheet at December 31, 1993 and 1992:

	1993	1992
	(Dollars in millions)	
Accumulated postretirement benefit obligation attributable to current retirees	24,133.2	20,316
Fully eligible active plan participants	3,913.3	3,450
other active plan participants	17,577.1	14,652.4
Accumulated postretirement benefit obligation	45,623.6	38,418.4
Unamortized net amount resulting from changes in plan experience and actuarial assumptions	(7,703.6)	(2,867.7)
Net obligation recognized in the Consolidated Balance Sheet	37,920	35,550.7

The assumed weighted average discount rate used in determining the actuarial present value of the accumulated postretirement benefit obligation was 7.0% and 8.55% at December 31, 1993 and 1992, respectively. A one percentage point increase in the weighted average discount rate used in 1993 would decrease the accumulated postretirement benefit obligation by approximately $5,500 million. The assumed weighted average rate of increase in future compensation levels related to pay-related life insurance benefits was 4.2% at December 31, 1993 and 4.5% at December 31, 1992.

The assumed weighted average health-care cost trend rate is 9.12% in 1994; this rate decreases on a linear basis through 2002, reaches an ultimate weighted average trend rate of 5.5% in 2006, and remains constant thereafter. The assumed trend rate for 1993 used to determine the December 31, 1992 accumulated postretirement benefit obligation above was 9.7% although such 1993 trend rate was adjusted to actual in determining the 1993 year-end obligation. A one percentage point increase in each year of the annual trend rate would increase the accumulated postretirement benefit obligation at December 31,1993 and 1992 by approximately $5,700 million and $4,650 million, respectively, and increase the service and interest cost components of the 1993 and 1992 postretirement benefit expense by approximately $550 million and $500 million, respectively.

AT&T CORP

CONSOLIDATED BALANCE SHEETS
At December 31

	1995	1994
	(Dollars in Millions)	
LIABILITIES		
Accounts payable	7,071	6,011
Payroll and benefit-related liabilities	6,256	4,105
Postretirement and postemployment benefit liabilities	405	1,029
Debt maturing within one year	16,589	13,666
Dividends payable	527	518
Other current liabilities	8,524	5,601
TOTAL CURRENT LIABILITIES	39,372	30,930
Long-term debt including capital leases	11,635	11,358
Long-term postretirement and postemployment benefit liabilities	8,908	8,754
Other long-term liabilities	5,170	4,285
Deferred income tax credits	5,199	3,913
Unamortized investment tax credits	199	232
Other deferred credits	400	776
TOTAL LIABILITIES	70,883	60,248
TOTAL COMMON SHAREOWNERS' EQUITY	17,274	17,921
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	88,884	79,262

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31
Dollars in millions (Except per share amounts)

	1995	1994	1993
TOTAL REVENUES	79,609	75,094	69,351
TOTAL COSTS	49,530	44,382	41,705
GROSS MARGIN	30,079	30,712	27,646
OPERATING EXPENSES			
Selling, general and administrative expenses	25,146	19,653	18,037
Research and development expenses	3,718	3,110	3,111
TOTAL OPERATING EXPENSES	28,864	22,763	21,148
OPERATING INCOME	1,215	7,949	6,498
Other income - net	458	293	546
Loss on sale of stock by subsidiary	NA	NA	9
Interest expense	738	724	1,032
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGES PROVISION FOR INCOME TAXES	935	7,518	6,003
Provision for income taxes	796	2,808	2,301
Income before cumulative effects of accounting changes	139	4,710	3,702
Cumulative effects on prior years of changes in accounting for:			
Postretirement benefits (net of income tax benefit of $4,294)	NA	NA	(7,023)
Postemployment benefits (net of income tax benefit of $681)	NA	NA	(1,128)
Income taxes	NA	NA	(1,457)
Cumulative effects of accounting changes	NA	NA	(9,608)
NET INCOME (LOSS)	139	4,710	(5,906)
Cumulative effects of accounting changes	NA	NA	(6.21)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONSOLIDATION

POSTRETIREMENT BENEFITS We adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective January 1, 1993. This standard requires us to accrue estimated future retiree benefits during the years employees are working and accumulating these benefits. Previously, we expensed health care benefits as claims were incurred and life insurance benefits as plans were funded.

In 1993, we recorded a one-time pretax charge for the unfunded portion of these liabilities of $11,317 ($7,023, or $4.54 per share, after taxes). apart from these cumulative effects on prior years of the accounting change, this change in accounting has no material effect on net income and it does not affect cash flows.

NOTE 13 - POSTRETIREMENT BENEFITS Our benefit plans for retirees include health care benefits, life insurance coverage and telephone concessions. This table shows the components of the net postretirement benefit cost:

	1995	1994
Service cost - benefits earned during the period	98	108
Interest cost on accumulated postretirement benefit obligation	888	852
Expected return on plan assets (*)	(298)	(243)
Amortization of unrecognized prior service costs	67	14
Amortization of net loss (gain)	(14)	1
Charge for special options	11	-
Net postretirement benefit cost	752	732

(*) the actual return on plan assets was $962 in 1995 and $(30) in 1994.

We had approximately 146,700 retirees in 1995, 144,900 in 1994, and 142,200 in 1993.

Our plan assets consist primarily of listed stocks, corporate and governmental debt, cash and cash equivalents, and life insurance contracts. The following table shows the funded status of our postretirement benefit plans reconciled with the amounts recognized in the consolidated balance sheets:

	1995	1994
At December 31		
Accumulated postretirement benefit obligation:		
Retirees	8,250	7,476
Fully eligible active plan participants	1,453	822
Other active plan participants	2,869	1,751
Accumulated postretirement benefit obligation	12,572	10,049
Plan assets at fair value	4,704	3,291
Unfunded postretirement obligation	7,868	6,758
Less:		
Unrecognized prior service costs	771	(46)
Unrecognized net (gain) loss	(292)	(1,012)
Accrued postretirement benefit obligation	7,389	7,816

We made these assumptions in valuing our postretirement benefit obligation at December 31:

	1995	1994
Weighted-average discount rate	7.0%	8.8%
Expected long-term rate of return on plan assets	9.0%	9.0%
Assumed rate of increase in the per capita cost of covered health care benefits	6.1%	8.6%

We assumed that the growth in the per capita cost of covered health care benefits (the health care cost trend rate) would gradually decline after 1995 to 4.9% by the year 2005 and then remain level. This assumption greatly affects the amounts reported. To illustrate, increasing the assumed trend rate by 1% in each year would raise our accumulated postretirement benefit obligation at December 31, 1995 by $646 and out 1995 postretirement benefit costs by $53.

NATIONAL STEEL CORP

CONSOLIDATED BALANCE SHEET
December 31
(In Thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	1995	1994
Accounts payable	255,574	272,586
salaries and wages	89,987	54,207
Withheld and accrued taxes	82,076	77,637
Pension and other employee benefits	96,894	93,902
Other accrued liabilities	68,373	61,422
Income taxes	3,912	2,775
Current portion of long term obligations	35,750	35,669
Long term obligations	339,613	360,375
Long term obligations to related parties	161,912	310,409
Long term pension liability	326,151	267,478
Postretirement benefits other than pensions	221,627	179,507
Other long term liabilities	364,423	363,307
Total Liabilities	2,111,322	2,145,804
Total Stockholders' Equity	556,557	353,581
Total Liabilities and Stockholders' equity	2,667,879	2,499,385

STATEMENT OF CONSOLIDATED INCOME
December 31
(In Thousands)

	1995	1994	1993
Net Sales	2,954,218	2,700,273	2,418,800
Cost of products sold	2,527,521	2,353,970	2,253,972
Selling, general and administrative	153,690	138,223	1 36,656
Depreciation, depletion and amortization	145,452	141,869	137,500
Equity income of affiliates	(8,767)	(5,464)	(2,160)
Unusual charges (credits)	5,336	(24,888)	110,966
Income from Operations	130,986	96,563	(218,134)
Other (income) expense			
Interest and other financial income	(11,736)	(5,542)	(1,862)
Interest and other financial expense	50,950	61,241	63,647
Litigation judgment income	NA	(110,972)	NA
Income (loss) before income taxes, extraordinary item and cumulative effect of accounting change	91,772	151,836	279,919
Income tax credit	(13,651)	(16,676)	(37,511)
Income before extraordinary item and cumulative effect of accounting change	105,423	168,512	(242,408)
Extraordinary item	.13	NA	NA
Cumulative effect of accounting change	NA	NA	(16,453)
Net income (loss)	110,796	168,512	(258,861)

Note A - Significant Accounting Policies Accounting Changes - During 1993, the Company adopted two new financial Accounting Standards Board Statements, "Accounting for postretirement Benefits Other Than Pensions" ("SFAS 106" or "OPEB") and "Employer's Accounting for Postemployment Benefits" ("SFAS 112"). (See Note E - Postretirement Benefits Other than Pensions and Note F - Postemployment Benefits).

Note E - Postretirement Benefits Other Than Pensions The Company provides contributory health care and life insurance benefits for certain retirees and their dependents. Generally, employees are eligible to participate in the medical benefit plans if they retired under one of the Company's pension plans on other than a deferred vested basis, and at the time of retirement had at least 15 years of continuous service. However, salaried employees hired after January 1, 1993 are not eligible to participate in the plans.

Effective January 1, 1993, the Company implemented SFAS 106 which requires accrual of retiree medical and life insurance benefits as these benefits are earned rather than recognition of these costs as claims are paid. The Company has elected to amortize its transition obligation over 20 years, 17 of which remain at December 31, 1995. In 1993, the excess of total postretirement benefit expense recorded under SFAS 106 over the Company's former method of accounting for these benefits was 97.6 million, or 59.5 million excluding curtailment charges, or $1.77 and $1.087 per share net of tax, respectively.

The components of postretirement benefit cost and related actuarial assumptions were as follows:

	1995	1994	1993
	(Dollars in thousands)		
Assumptions:			
Discount rate	8.75%	7.75%	8.75%
Health care trend rate	7.8%	10.0%	11.2%
Postretirement benefit cost:			
Service cost	10,573	13,737	12,912
Interest cost	52,700	53,577	52,811
Amortization of transition obligation	26,274	26,510	28,071
Other	(5,003)	(2,162)	(8,176)
net periodic benefit cost	84,544	91,662	85,618
Curtailment charges and special termination charges (credits)	---	(4,081)	38,061
Total postretirement benefit cost	84,544	87,581	123,679

The following represents the plans' funded status reconciled with the amounts recognized in the Company's balance sheet and related actuarial assumptions:

	1995	1994
	(Dollars in thousands)	
Assumptions:		
Discount rate	7.25%	8.75%
Health care trend rate	7.2%	7.8%
Accumulated postretirement benefit obligation ("APBO")		
Retirees	525,567	476,950
Fully eligible active participants	85,871	78,161
Other active participants	107,388	90,514
Total	718,826	645,625
Plan assets at fair value	33,201	21,105
APBO in excess of plan assets	685,625	624,520
Unrecognized transition obligation	(446,654)	(477,489)
Unrecognized net gain (loss)	(7,344)	42,476
Total postretirement benefit liability	231,627	189,507
Less postretirement benefit liability due within one year	10,000	10,000

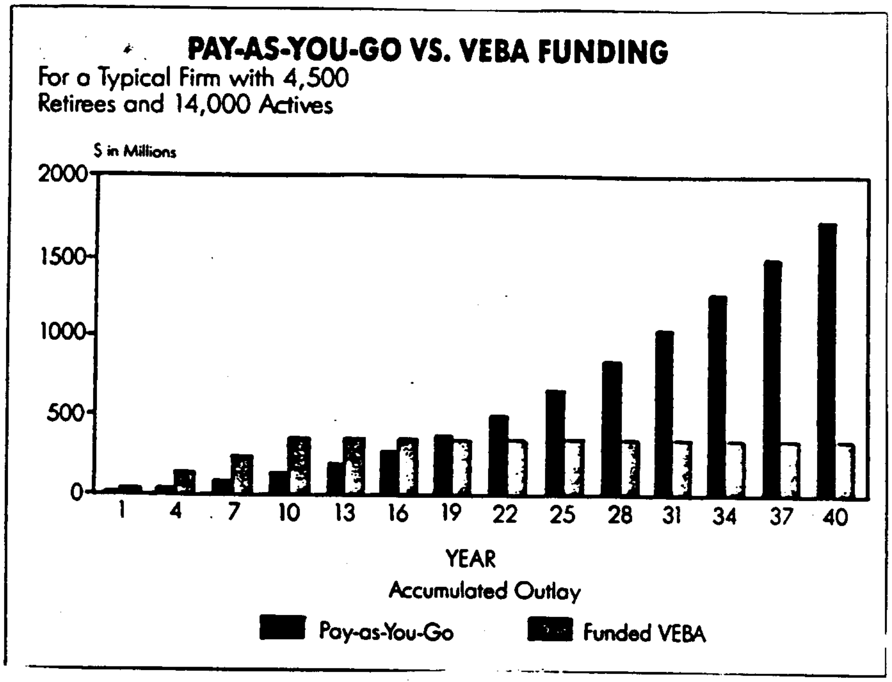
Long term postretirement benefit liability	221,627	179,507

As a result of the decrease in the long term interest rates at December 31, 1995, the Company decreased the discount rate to calculate the actuarial present value of its APBO by 150 basis points to 7.25% from the rate used at December 31, 1994. This is the primary reason for the increase in the APBO. The assumed health care cost trend rate of 7.2% in 1996 decreased gradually to the ultimate trend rate of 5% in 2002 and thereafter. A 1% increase in the assumed health care cost trend rate would have increased the APBO at December 31, 1995, and postretirement benefit cost for 1995 by $60.3 million and $55.7 million, respectively.

In connection with the 1993 Settlement Agreement between the Company and the USWA, the Company began prefunding the OPEB obligation with respect to USWA represented employees in 1994. Pursuant to the terms of the 1993 Settlement agreement, a Voluntary Employee Benefit Association trust (the "VEBA Trust") was established. Under the terms of the agreement, the Company agreed to contribute a minimum of $10 million annually and, under certain circumstances, additional amounts calculated as set forth in the 1993 Settlement Agreement. In 1995, the Company contributed $10 million to the VEBA Trust. In 1994 the Company contributed $21 million to the VEBA Trust, comprised of the $10 million annual minimum contribution together with $11 million related to the proceeds received in connection with the B&LE litigation settlement. VEBA Trust assets of 33.2 million at December 31, 1995 were comprised of 60% equity investments and 40% fixed income investments.

APPENDIX B

VEBA FUNDING

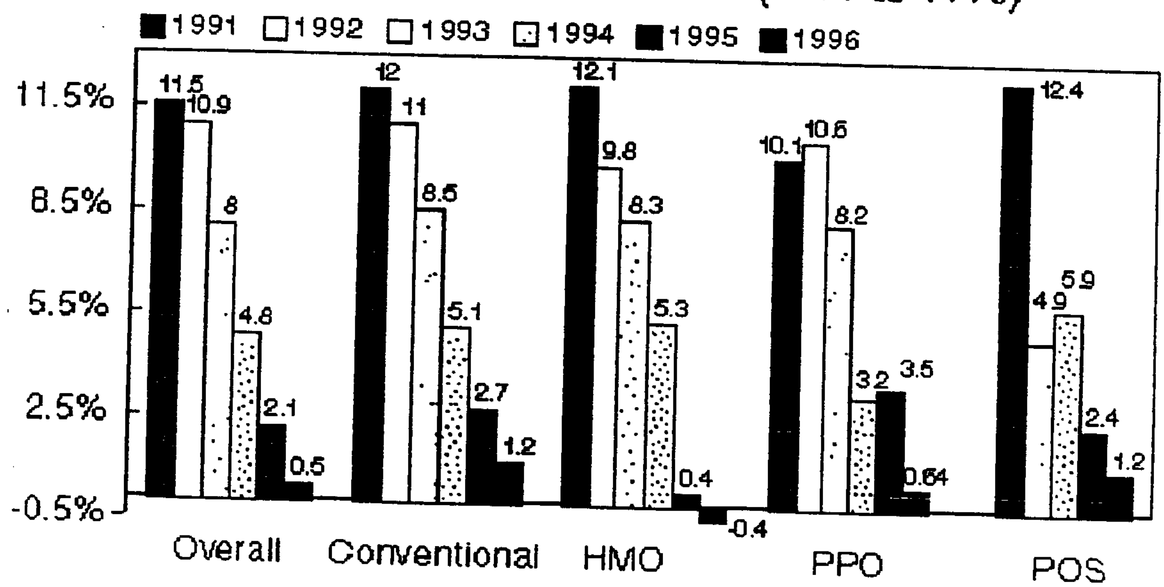


SOURCE: (Bazzle 29)

APPENDIX C

HEALTH INSURANCE PREMIUMS

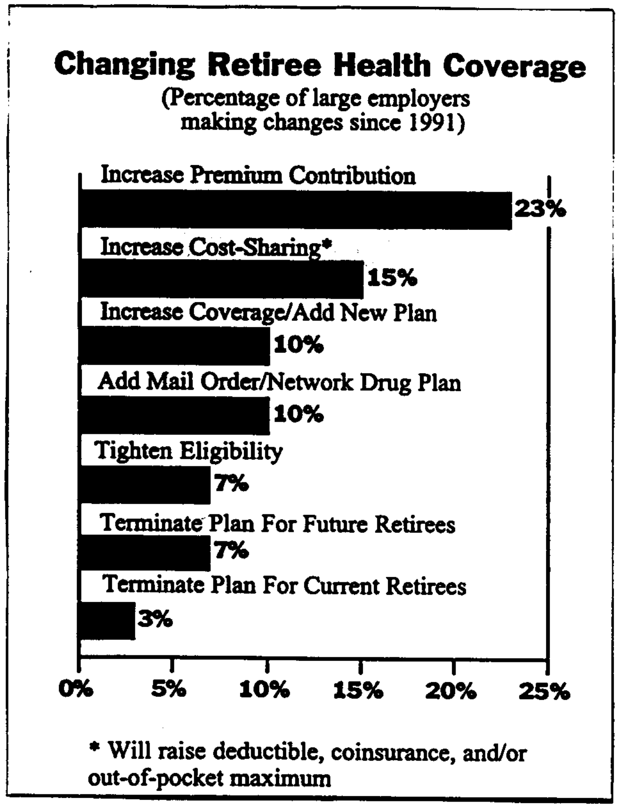
Figure 1. Health Insurance Premiums Increase 0.5% as Inflation Cools (1991 to 1996)



SOURCE: (KPMG, "Your Health Care Premium Increases Should Be Less Than 1%", 1)

APPENDIX D

CHANGES IN RETIREMENT HEALTH COVERAGE



SOURCE: ("Fewer Plans, Higher Cost for Retirees, Reported by Survey" 24)

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